

4. *Study the extract below and answer the questions that follow.*

Thai finance minister happy with exchange rate

- ❶ The Thai finance minister said the current level of the Thai baht (Thailand's currency) was appropriate and that the Bank of Thailand was broadly allowing the **exchange rate** to be set by the market. The central bank's responsibility is only to prevent the value of the Thai baht from disrupting the economy. The minister also said that he was certain official interest rates would go even lower. The Bank of Thailand has cut its benchmark rate by 2.25 % since December 2008, taking it to a four and a half year low of 1.5 %.
- ❷ Asked if the Thai baht needed to weaken further, he said "it has been weakening, but relative to other currencies, I think its current value is fair. Exporters always want to see their currencies weaker, but I think the relative exchange rate for Thailand is appropriate. I also believe the central bank has left it to market forces, which I think is correct," he added. The Thai baht hit its lowest value against the US dollar in over a year recently, and some dealers believed the central bank was pushing it down to help exporters.
- ❸ The minister was asked if he thought **interest rates** had reached the lowest possible level. "Given the struggling export sector, which contributes to a lack of aggregate demand and a danger of increased unemployment, I am quite certain there is more to come. I would expect to see interest rates fall further unless there is a very rapid change in economic conditions."
- ❹ Thailand's state planning agency reported last week that GDP fell a record 6.1 % in the fourth quarter of 2008. It expects zero GDP growth at best in 2009, and says the economy could shrink by as much as 1 %. According to this agency, unemployment is expected to rise to 2.5 %, up from 1.4 % in 2008, while the Commerce Ministry announced that exports had fallen 26.1 % compared with the previous year.

[Source: adapted from "Thai exports drop 26 % in April", <http://www.chinaview.cn>, 20 May 2009;
 "Thai unemployment to jump in 2009 – planning agency", 8 December 2008 and
 "Thai finmin sees rates lower, happy with baht", 2 March 2009, <http://www.reuters.com>]

(This question continues on the following page)

(Question 4 continued)

- (a) Define the following terms indicated in bold in the text:
- (i) exchange rate (*paragraph 1*) [2 marks]
 - (ii) interest rates (*paragraph 3*). [2 marks]
- (b) Using an appropriate diagram, explain how Thailand's central bank might intervene to lower the value of the Thai baht. [4 marks]
- (c) With the aid of an AD/AS diagram, explain the likely effect on the Thai economy of a further cut in interest rates (*paragraph 3*). [4 marks]
- (d) Using information from the text/data and your knowledge of economics, evaluate the view that Thailand's central bank should intervene in the foreign exchange market in order to weaken the Thai baht. [8 marks]